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“Bad News is Good News”

June 28, 2022

The following are the Exclusive and Sole Opinions of the Author.

Preface

The US economy is failing due to mismanagement. Going from a virtuous expansion in 2018 to a disaster of stagflation and instability in 2022. Hard not to use invective or labels to describe the debasement of our society by predatory elites and favored interest groups. Washington has devolved from a swamp into a cesspool.

It is never different this time. Or is it?

There have been seven bear markets (and recessions) of varying degrees and duration over the last 50 years.[1] *Sentiment and momentum indicators are now at levels as low or lower than seen at the end of previous major bear markets. The high correlation of major bottoms with the extreme negative readings is astonishing. The markets begin to mend before the known information changes. Almost magic, reading the future.*

“Magic” suggests an investor ignore everything except extreme sentiment and momentum indicators. It requires an investor to look past the present economic situation, to take a leap of faith.

Always hard to embrace and comprehend, particularly today.

[1] https://www.investopedia.com/a-history-of-bear-markets-4582652

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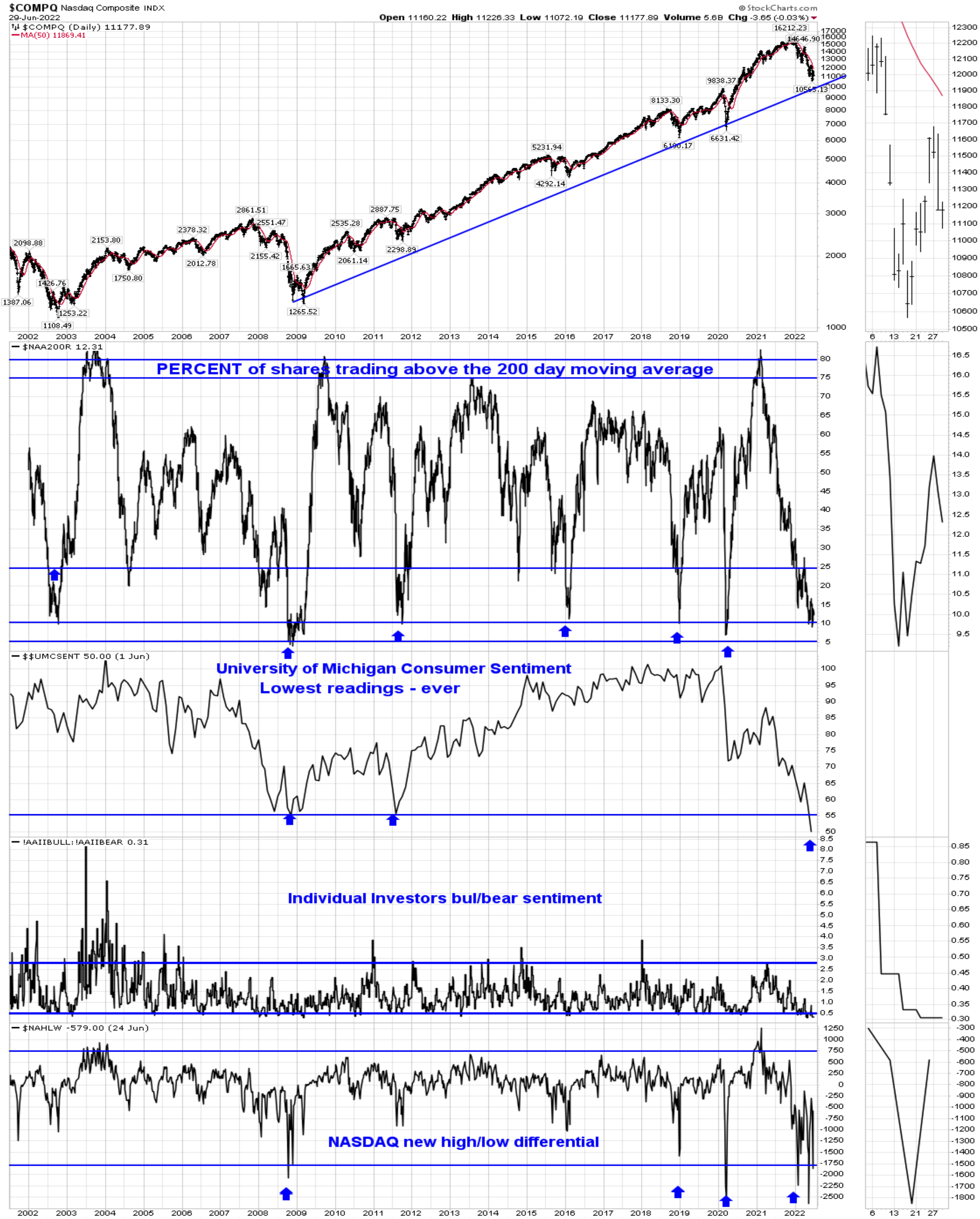


Bear markets begin to end when the "causes" of economic underperformance are identified. Bull markets begin when remedies are enacted. The good news is that the markets have identified some of the specific issues that need to be addressed.

Competence, Money, Energy

The Nation's leadership is not considered credible or competent, unable to accomplish the mundane business of keeping the ships, airplanes and trains running, let alone address the challenges of the moment.

The nations monetary policy leadership is consistently incompetent, failing to achieve either of their mandates of price stability and full employment.[2]

The scarcity of energy supplies is a self-inflicted disaster, entirely domestic, the easiest major economic problem to fix.

Leadership

Demand destruction is what the proletariat experience as a decline of their standard of living. Few believe that the President or his cabinet "feels your pain." "Drive electric cars" is their wiseacre response to the masses.

Voters will not wait until 2025 for new economic policy from a new president. They want changes in their day to day lives, now. Media censorship and voting irregularities will not be enough to change the outcomes in 2022 midterm elections.

Whether the midterm referendum will result in major policy change is an open question. Emulating William Jefferson Clinton in this respect would be salutary. A move toward the center requires mental agility not apparent at any level of this administration.

[2] One of the most unusual characteristics of the 2016-2018 period.

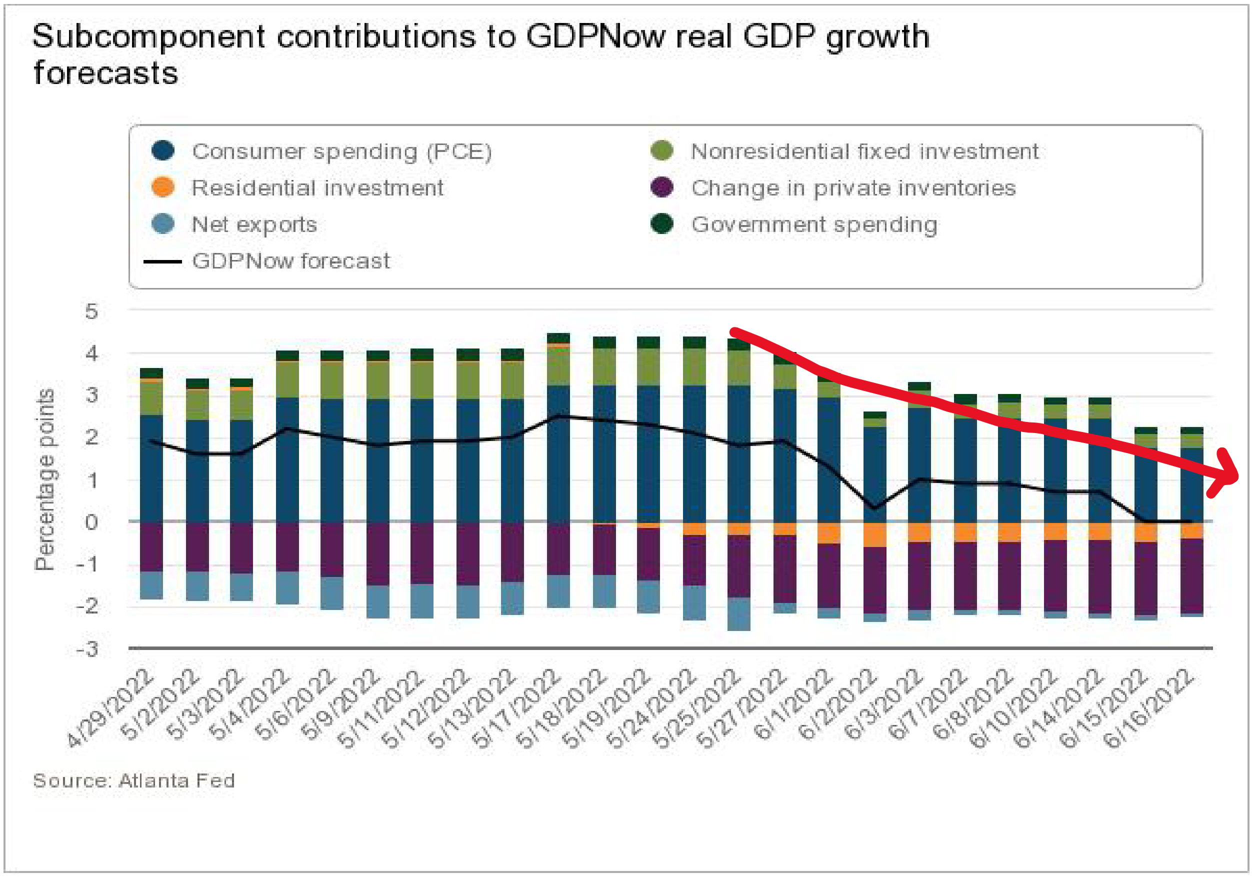
The FED, the Economy, and the Stock Market

The economic policy establishment is overwhelmed by an inflationary disaster of their own making. We were lectured that reigniting inflation was a great idea; a little bit of poison is good for you! They intentionally promoted inflation, promised to, and did let it run hot.

Now, one year later, the intent is to control inflation by destroying demand. The FED can readily destroy demand, not create a sound economy. They are succeeding, driving the economy into a precipitous recession. Once a trend is established, so are negative feedback loops. Already in recession, the FED will overshoot – substantially. That is what happens when you function in the past, by looking in the rearview mirror.

The elites seem supremely indifferent. The bourgeoisie, investors are far too sanguine. Every consumer in America is repeatedly slapped in the face by soaring inflation and energy shortages. Those that can defer spending, will – others will stop because they have no alternative. They have burned through their discretionary income and savings – with little or no prospect of catching up. Credit quality is clearly beginning to deteriorate just as credit card balances soar. The United States is a consumer-oriented economy heading into a spending strike.

A recession is already underway, regardless of the "official" definition of two quarters of negative GDP growth IN A ROW. **Nothing magic about two in a row, three out of five would be brutal, worse. A severe contraction is a distinct possibility**.



ENERGY

The surge in money supply DID NOT create the shortages of energy. Nor did the Ukraine war. Demand increased as the economy recovered, at the same time domestic supplies were intentionally reduced by a draconian wide ranging anti-fossil fuel policy agenda.

Fossil fuels are essential to the economy and will be for the many decades. Energy transition is an economic phenomenon. It could and should have evolved in a free market, which always moves toward more efficiency. Batteries, windmills, and solar power are ancient technologies compared to the breakthrough of light emitting diodes, LEDs. Major technology breakthroughs are needed to fulfill the promise of electric vehicles.[3]

The administration "shut down the energy factory" as well as constraining capital availability for new energy development without adequate replacement technologies or supplies. The baby food fiasco is minor by comparison, but illustrative.

Energy production in the needed quantities is a long lead time process. There is no spare capacity or capital available to significantly increase production. The energy industry had been devastated by years of losses. Starved for capital they struggled to survive. Now their imperative is to recover costs and take profits as quickly as possible, uncertain about the long term returns of and on investments.

Terminal values and stranded costs are the rubrics of dying businesses and are antithetical to investment in reserves and production.

Current production must be maintained before production can be increased. There is no way to fly in emergency supplies from hostile nations, or enough oil in the SPR to change the outcomes.[4]

The economic impact of energy shortages is growing and spreading throughout the economy.

$5 gasoline is enough to destroy a staggering amount of demand – never mind the inevitable soaring utility bills due to the excessive cost of natural gas.

Americans are not going to cooperate or submit to economic suicide. **Investors should anticipate changes in energy policy.** Another leap of faith

It is unlikely that the shift in control in the Senate and House in the November elections will provide the majorities to begin the restoration immediately. Makes the prospect for a return to economic growth and prosperity more remote. Not hopeless – just going to take more time to put the Nation's house back in order.

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[3] The added weight of the batteries requires more energy to move and stop than a lighter conventional vehicle. This fundamental reality cannot be overcome using current technologies. Beyond physics, the adequacy of electricity supplies, raw materials and recycling promise become insoluble problems if EVs proliferate. https://www.wsj.com/articles/tesla-ford-and-gm-raise-ev-prices-as-costs-demand-grow-11656241381?st=oiir92xhcikwe03&reflink=desktopwebshare_permalink

[4] The SPR was not intended for a sudden unexpected short-term emergency, not domestic policy failures. "Emergency Drawdowns: The SPR exists, first and foremost, as an emergency response tool the President can use should the United States be confronted with an economically threatening disruption in oil supplies.
2011 IEA Coordinated Release
2005 Hurricane Katrina Sale
1991 Operation Desert Storm Sale"
https://www.energy.gov/fecm/strategic-petroleum-reserve-0

INVESTING IN THE RECESSION

BAD NEWS IS GOOD NEWS – Not Oxymorons

Leading from behind, The FED, will realize that the "mild recession that is good for you" is already out of their control.**The slowdown is shockingly rapid and will force the FED to recant their hysterical dot plots.** Each episode of bad news will be seen as tempering the FED's crusade to exacerbate the recession.

Price earnings ratios are falling, even faster than earnings projections. Extra columns are added to the previous matrix to illustrate lower, potential bear market valuations. **$200 in earnings at 14 multiple yields a S&P 500 target of 2,800.**

					S&P 500						
	EARNINGS										
P.E. RATIO	250	245	240	235	230	225	220	215	210	205	200
25	6250	6125	6000	5875	5750	5625	5500	5375	5250	5125	5000
24	6000	5880	5760	5640	5520	5400	5280	5160	5040	4920	4800
23	5750	5635	5520	5405	5290	5175	5060	4945	4830	4715	4600
22	5500	5390	5280	5170	5060	4950	4840	4730	4620	4510	4400
21	5250	5145	5040	4935	4830	4725	4620	4515	4410	4305	4200
20	5000	4900	4800	4700	4600	4500	4400	4300	4200	4100	4000
19	4750	4655	4560	4465	4370	4275	4180	4085	3990	3895	3800
18	4500	4410	4320	4230	4140	4050	3960	3870	3780	3690	3600
17	4250	4165	4080	3995	3910	3825	3740	3655	3570	3485	3400
16	4000	3920	3840	3760	3680	3600	3520	3440	3360	3280	3200
15	3750	3675	3600	3525	3450	3375	3300	3225	3150	3075	3000
14	3500	3430	3360	3290	3220	3150	3080	3010	2940	2870	2800
13	3250	3185	3120	3055	2990	2925	2860	2795	2730	2665	2600
12	3000	2940	2880	2820	2760	2700	2640	2580	2520	2460	2400

Disenchanted

The concept of "Magic" suggests an investor ignore everything except extreme sentiment and momentum indicators. A leap of faith is required, investors need to look past the present economic situation for a return to "normalcy."

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While bear markets arise from unique circumstances, the commonalities are paramount. IT IS NEVER DIFFERENT THIS TIME.

A leap of faith is not a plunge or blind jump. It is an informed choice based on historical precedent. The coincidence of internal indicators with significant market lows is apparent but not the precise timing and pricing of the lows. That is the leap!

Sound fundamentals and reasonable valuations are the fundamental investment themes. Free cash flow analysis[5] and growth at a reasonable price, (GARP) [6], have proven resilient.

Trading techniques can be used to address the timing issue. (Accumulating positions over time, dividend reinvesting, trailing buy stop orders or more sophisticated strategies depending on the portfolio and the investor.)

EPILOGUE

Buy at high valuations, expect lower returns, buy at average valuations, expect average returns, buy at low valuations, expect higher returns.

Valuations are "catching up" to the historically low readings of the internal indicators.

Buy the best for less.

[5] Free cash flow is the cash remaining after a company has paid expenses, interest, taxes, and long-term investments. It can be used to buy back stock, pay dividends, or participate in mergers and acquisitions. https://www.paceretfs.com/products/cowz

[6] The Index is composed of approximately 75 securities in the S&P 500® Index that have been identified as having the highest "growth scores" and "quality and value composite scores," calculated pursuant to the index methodology. https://www.invesco.com/us-rest/contentdetail?contentId=34cde97fa4bae410VgnVCM100000c2f1bf0aRCRD&dnsName=us

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